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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

July 2, 1996

Mr. William F. Caton
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Ex Parte in Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; CC Docket No. 96-98

Dear Mr. Caton:

Pursuant to Commissioner Ness' and Commissioner Chong's request, MCI is providing the attached analysts' reports.

Sincerely yours,

Mary L Brown

Mary L. Brown

Enclosure
MLB

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Merrill Lynch

14 May 1996

Telecom Services — RBOCs & GTE

First Quarter Review: Price Caps Unleash Operating Leverage; Efficiency Gains and New Services Drive Double Digit EPS Growth

- RBOCs and GTE beat our forecasts once again and thus we have raised many of our EPS estimates and 5- year growth rates. With 70% of telephone revenues now under pure price caps, local telcos' natural operating leverage has been unleashed. High margin vertical services (2nd lines, voice mail, caller ID, etc.), overall increased usage, and intensified cost management are creating margin expansion which now can flow to the bottom line. Table 2 provides a company-by-company summary of progress away from earnings and toward price regulation.

- With RBOCs preparing to meet the Law's checklist and the FCC preparing to review RBOC requests, for the RBOCs/GTE we view accelerating local competition and entry into LD as offsetting events. RBOCs as resellers of LD benefit from more choices and thus more buying power than resellers of local capacity. And, for the RBOCs/GTE, long distance is simply another high margin, low capital intensity vertical service — perhaps the *ultimate* vertical service.

- Recent merger announcements (SBC/PAC; BEL/NYN) should raise investor awareness of value-enhancing synergies, operating leverage and expanded long distance footprints. With price caps and long distance driving mergers, we expect additional mergers, even 3-way mergers, of local telcos to resume once these two are approved.

- We continue to recommend the RBOCs and GTE: With above-market growth and defensiveness and double the market's yield, we believe current 14% P/E discounts to the S&P 500 offer 20% or more upside to a 10% premium. Our favorites are SBC and Ameritech (both rated B-2-1-7) and BellSouth (B-2-2-7).

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Investment Rating Key:

1 - Buy	6 - No Rating
2 - Accumulate	7 - Same/Higher Dividend/distribution is considered to be secure
3 - Neutral	8 - Same/Lower Dividend/distribution is not considered to be entirely secure
4 - Reduce	9 - Pays no cash dividend
5 - Sell	

Investment Risk Rating

A - Low Risk B - Average Risk C - Above Average Risk D - High Risk

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Table 1

Company Comparisons

Company	QRQ Rating	Price @ 5/14/96	EPS * 1995A	EPS * 1996E	EPS * 1997E	P/E Ratio 1995A	P/E Ratio 1996E	P/E Ratio 1997E	Quarterly EPS * 1Q95	Quarterly EPS * 1Q96	Quarterly EPS * % chg	5-Yr EPS Growth	Div Yield	96E Div Payout	1996 % Internally Financed	1996E EBITDA Mult.
Ameritech (AIT)	**B-2-1-7**	**$58.75**	**$3.41**	**$3.82**	**$4.25**	**17.2**	**15.4**	**13.8**	**0.76**	**0.86**	13.7%	**10%**	**3.6%**	**55%**	**132%**	**6.6**
Bell Atlantic (BEL) **	RSTR	$64.88	$3.88	$4.30	$4.95	16.7	15.1	13.1	0.95	1.07	12.8%	12%	4.4%	67%	121%	6.4
BellSouth (BLS)	B-2-2-7	$41.13	$2.24	$2.50	$2.75	18.4	16.5	15.0	0.55	0.63	13.7%	10%	3.5%	52%	121%	5.9
NYNEX (NYN) **	RSTR	$48.63	$3.28	$3.57	$3.87	14.8	13.6	12.6	0.72	0.83	15.0%	8%	4.9%	66%	109%	5.9
Pacific Telesis (PAC) /p/	B-2-2-8	$33.88	$2.48	$2.60	$2.45	13.7	13.0	13.8	0.67	0.70	4.6%	5%	6.5%	84%	81%	5.1
SBC Comm.(SBC) /p/	**B-2-1-7**	**$50.13**	**$3.08**	**$3.45**	**$3.70**	**16.3**	**14.5**	**13.5**	**0.65**	**0.76**	17.2%	**11%**	**3.4%**	**50%**	**137%**	**6.4**
U S WEST Comm. (USW) /p/	B-2-2-7	$34.38	$2.35	$2.45	$2.60	14.6	14.0	13.2	0.59	0.61	4.7%	7%	6.2%	87%	95%	5.1
RBOC Average						16.0	14.6	13.6			11.5%	9%	4.6%	66%	114%	5.9
GTE	B-2-2-7	$44.38	$2.61	$2.87	$3.15	17.0	15.5	14.1	0.56	0.62	10.7%	10%	4.2%	66%	104%	5.8
S&P 500		666	$37.25	$39.50	$40.25	17.9	16.9	16.5				7%	2.1%	36%		

*Adjusted to exclude non-recurring items.
% Internally financed = (Net Income + Depreciation)/(CAPX + Dividends)
**Bell Atlantic and NYNEX are restricted. Solictation of commission orders for these stocks is prohibited.

Merrill Lynch is currently acting as financial advisor and has rendered a fairness opinion to Bell Atlantic in connection with the proposed merger with NYNEX announced on April 22, 1996. Bell Atlantic has agreed to pay a fee to Merrill Lynch for its financial advisory services, a significant portion of which is contingent upon the consumation of the proposed merger. The proposed acquisition is subject to approval by shareholders of Bell Atlantic and NYNEX. This research report is not intended to (I) provide voting advise, (ii) serve as an endorsement of the proposed transaction, or (iii) result in the procurement, withholding or revocation of a proxy.
M&A Footnote: Add to Table – See Compliance Version

First Quarter Highlights

- The RBOCs' recurring 1Q EPS growth averaged 11.5%, much higher than 4Q's 5.8%. SBC Communications led the RBOCs with an EPS gain of 17.2%, followed by NYNEX, BellSouth and Ameritech, Bell Atlantic, GTE, and Pacific Telesis. U S WEST showed the weakest quarterly results with a recurring EPS growth rate of 4.5%. Excluding Pacific Telesis and U S WEST, EPS growth averaged an impressive 14.5% in 1Q, up from 9% in the fourth quarter. We raised our estimates for all of the RBOCs except U S WEST. GTE's estimates remained unchanged as well. We now forecast average recurring EPS growth of 9.3% in 1996 and 7.4% in 1997. Excluding Pacific Telesis and U S WEST, we forecast average growth of 11.1% in 1996 and 10.4% in 1997.

- Access line growth for the RBOCs averaged 4.3% in 1Q, much better than our forecast of 4.0% and the fourth quarter's 3.9%. High usage business line growth accelerated to 6.8%, up from the fourth quarter's 6.5%, while residential line growth accelerated to 3.3% from the fourth quarter's 2.8% due to continued aggressive second line marketing campaigns by all of the RBOCs and increasing second line penetration along with favorable economic conditions in most areas. Average long distance minutes of use grew 10.8% year-over-year in the first quarter, up 120 basis points from the fourth quarter's 9.6%.

- The RBOCs' cellular operations had a slightly better than expected 1Q, with an average annual penetration gain of 2.15% vs. our forecast of 2.13%, and up significantly from the year ago first quarter's 1.66%. RBOC subscriber growth averaged 35.1% year-over-year, down from 39% in the prior quarter and cellular revenues grew an average 26.8% annually, down from the fourth quarter's 28.5% — the gap reflects an average 6.9% year-over-year decline in revenue per subscriber in 1Q, worse than the 4Q's 5.4% decline.

Investment Conclusion:

For the 7 RBOCs and GTE, first quarter 1996 was better than our forecast. We raised many of our 1996 estimates and growth rates, attributable to the emergence of operating leverage under new price cap regulatory plans. Second lines, vertical services with high incremental margins, overall increased usage, and intensified cost management are creating margin expansion which now can flow to the bottom line. Offering long distance to in region customers will be the ultimate vertical service — though we do not expect initial FCC approval for an additional 1 1/2 — 2 years. We continue to rate the RBOCs and GTE at Accumulate (2) or higher and see more than 20% upside on average.

Price Caps Unleash Operating Leverage

The positive first quarter results derive from the long-dormant (and ignored) but newly-activated operating leverage of the local phone industry. Suppressed by various forms of rate of return (i.e., earnings) regulation, this operating leverage is emerging as a result of 1995's dramatic progress toward price instead of ROR regulation. In 1995, FCC and numerous state regulators dramatically loosened the regulatory environment — moving by our calculations from yearend 1994 with only 20% of RBOC/GTE telephone revenue streams regulated by pure price caps to 70% currently and likely to rise further in the future.

"% of [illegible] Pure Price Caps*"

	[illegible]	Current
Ameritech	[illegible]	100%
Bell Atlantic	[illegible]	61%
BellSouth	0%	100%
NYNEX [1]	[illegible]	[illegible]
Pacific Telesis [2]	[illegible] E	[illegible]
SBC [3]	[illegible]	100%
US WEST [4]	10% E	37%
GTE	8% E	33%
Weighted Average	20%	70%
Excluding PAC and GTE	23%	83%

* Pure Price Caps means ROR methods (including sharing) are not used.
[1] Only Vermont, NH not under price reg.
[2] Nevada — commission approved, but rate caps to follow prob. 1996 (2% of revenues).
[3] Kansas law in effect thru 3/97, Missouri still technically under ROR, but no earnings review until [illegible], same for Arkansas thru 1996. OK still technically under ROR, but no review for the next couple years.
[4] Includes only states under pure price caps and does not include those states under other forms of incentive regulation.
E = Estimate, equal to 1996E less interstate access %.

New Incentives to Seek Efficiency Gains and Enhanced Services......

This has unleashed incentives to seek more efficiencies and to aggressively sell more units such as second lines and "vertical" features such as voice mailboxes, caller identification services, etc. With prices instead of earnings regulated, unit growth and cost reductions can flow directly to the bottom line — all while regulators and consumers are protected by guaranteed lower prices in accordance with an annually-adjusted price cap formula. This phenomenon is real and clearly a win-win for politicians, consumers and — for once — investors.

...At High Incremental Margins

An added benefit is that most of the new, fast-growing features generate high incremental margins. This is because they are software-based and thus carry low capital costs and, beyond marketing and service, low operating costs as well. With sales of second lines and features growing 25-50% per year and penetration rates still low at 10-20%, we believe much operating leverage remains and thus we remain quite comfortable with our 5-year compound annual EPS growth forecast of 9-10% for the 8 company average (i.e., 7 RBOCs and GTE). Further, many vertical services have yet to be marketed — some haven't even been invented, and of course, long distance for in region customers has not yet been approved by the FCC.

Table 3

"Vertical" Service Penetration

(% of in-region residential customers)

		Penetration Rates [1]						
	Residential Lines	Add'l Line Penetration	Call Waiting	Voice Mail	Caller ID	New Service #1*	New Service #2*	In-Region LD
Ameritech	12,364	12%	46%	5%	19%	0%	0%	0%
Bell Atlantic	12,747	13%	43%	10%	13%	0%	0%	0%
BellSouth	14,865	10%	56%	11%	16%	0%	0%	0%
NYNEX	11,381	13%	40%	8%	12%	0%	0%	0%
PacTel	10,016	23%	48%	6%	0%	0%	0%	0%
SBC	9,651	13%	51%	7%	24%	0%	0%	0%
U S WEST	10,530	9%	40%	10%	11%	0%	0%	0%
Average		**13%**	**46%**	**8%**	**14%**	**0%**	**0%**	**0%**

[1] Penetration of total residential lines in service.
Does not adjust for residential lines marketed. Penetration rates for lines marketed would be slightly higher.
* New services, as yet uninvented, could boost future revenue growth at high incremental margins.

LD is Ultimate Vertical Service

The ultimate vertical service feature is long distance — which, once FCC approval is obtained, increases the typical RBOC's addressable market by 65% in gross revenue terms and nearly 40% in revenues net of access charges already collected by the RBOCs. We use the term *ultimate* because, like other vertical features, long distance can be offered to already existing customers with *minimal capital investment but unlike vertical features, customers do not have to be convinced to use it.* They already are using it; they just need to be convinced to change suppliers — something they do every day as evidenced by very high churn rates in the consumer long distance market and recent churning of some major corporate accounts from MCI to AT&T (e.g., IBM & Merrill Lynch among others).

Long Distance Can Offset Pain of Local Share Loss

In our view, the high incremental margins and low capital intensity of long distance enables the RBOCs and GTE to gain enough to offset the pain of losing (what we believe will be) comparable market share in the local telephone market. Indeed, because it is likely that the RBOCs will enjoy more of a buyers' market for long distance than the new entrants in the local market will enjoy for local capacity, we are able to reach our counterintuitive conclusions. For example, in contrast to many, we do not believe the RBOCs will lose more than they gain and this is despite the fact that the long distance market (including access) is 25% smaller than and has average margins only half of those in the local market. In fact, our math shows the RBOCs achieving INCREMENTAL long distance EBITDA margins in the 25% range which is comparable to those achieved on average by the major long distance companies today. However, one extremely important difference exists which is that very little capital (thus little depreciation or interest) will be expended — which translates into the **startling conclusion that the RBOCs can earn nearly 25% PRETAX margins in long distance, about twice what AT&T and MCI currently earn!** (Our math for

RBOC margins is as follows: access at 40% and SG&A at 25% of gross revenues, similar to AT&T; and leased long distance transport capacity at currently offered volume-purchase rates of $0.015/minute or 10% of gross revenues; and minor capital investment which, if spent, might enable self-supply of in-region long distance and thus lead to some bypassing of $0.015/minute transport charges and slightly higher margins.)

In-Region Long Distance: An Added Bonus

Incidentally, there seems to be a misunderstanding about in and out-of region long distance revenue opportunity for the RBOCs. If an RBOC territory has $10 billion of long distance revenues originating in its territory, 100% will be addressable once the FCC has authorized in-region entry. Some seem to believe that only the 45% or so that originates AND terminates in-region is addressable. The only difference is in incremental margins since minutes originating and terminating in-region could be carried more cheaply (say at $0.005/min.) on an RBOC's own network (say on PAC's already existing fiber from LA to San Francisco) than leased at $0.015/minute from a long distance carrier such as Sprint or Worldcom or even MCI. The margin difference is about 6 pct. points meaning if calls totally in-region could earn PRETAX margins in the high 25-30% range, calls terminating out-of-region (but originating in-region) could earn 20-25% incremental margins net of all sales and administrative costs, access and capital expenses. If we were to exclude access as some do and look at net revenues, by simple mathematics the margins go far higher to the 40% range. We continue to be amazed at how much confusion there is in the investment community over how to analyze incremental margins and addressable market opportunity for the RBOCs in long distance.

Merger Synergies Mean More Value Creation

Recent merger announcements should raise investor awareness of opportunities for synergies, operating leverage and expanded long distance footprints and thus **value creation and long term earnings growth enhancement from additional mergers. Mergers are driven by regulatory and federal law changes.**

PacTel/SBC: An Unexpected Pair, But The First Of The RBOC Mergers.......

As we have anticipated for over a year, the RBOC merger process began but with unexpected, non-contiguous players, PacTel and SBC. We view the April 1 announcement of a definitive merger agreement between these two companies as positive for both. This is because (a) merger synergies, which we estimate at $1 billion over 5 years, in SBC's 5-state territory should flow to net income and to shareholders under SBC's 100% price cap regulatory environment and (b) the merged company's cost and effectiveness of entry into long distance should benefit from an enlarged in-region footprint, above-average exposure to high profit/minute international traffic and significant cost sharing — the latter to include billing, customer service, product development, back office, telemarketing, etc. We expect the SBC/PAC merger to close in early 1997 after reviews by 7 state regulatory agencies, the FCC and the Department of Justice (the latter for antitrust issues which we do not expect to be roadblocks).

...Bell Atlantic & NYNEX Followed Shortly After

On April 22, Bell Atlantic and NYNEX announced a merger agreement. The announcement included indications by the companies that the deal would be accretive to EPS in the first year after closing (expected in about 12 months) and that synergies would result in $300 million in annual expense savings within a year from closing, growing to annual savings of $600 million by the third year. According to the announcements, merging the two companies should result in an estimated 1997 net income of $3.75 billion which translates into $4.79 per "old" Bell Atlantic share, $0.09 above our $4.70 estimate. The company's estimated $300 million of merger synergies translates to an additional after-tax EPS impact of $0.25 per old BEL share; however, we are assuming only two-thirds of the savings occur in calendar year 1997 and thus we added a further $0.16 to our EPS estimate. Therefore we increased our 1997 EPS estimate for an old BEL share from $4.70 to $4.95. From that base, the company indicated annual EPS growth rate would be increased about 200 b.p. to the 10-12% range, vs. the prior ranges of "the upper end of the 7-10%". **We have increased our 5-year EPS growth rate from an already above-consensus 10% to 12%.** The company is targeting an additional boost on the revenue side which is not factored into our revised estimate.

Further Consolidation Likely

Mergers create value so we expect additional consolidation. We believe the most likely candidates are Frontier and U S WEST, among others. We continue to view both the long distance and local telephone industries as likely to experience "within-segment" mergers. In long distance, we believe the process of Worldcom (WCOM; $49 5/8, D-3-2-9) /p/q/ absorbing smaller players will continue with Frontier (FRO, $30 1/2, C-2-2-7) as the best value and LCI (LCI, $29 1/4, D-3-2-9) /p/ also a candidate, though pricier. Our sum-of-the-parts takeout value for Frontier is $40-41. Among the RBOCs and GTE, almost anything is possible as evidenced by the SBC/PAC non-contiguous merger. However, we would focus our attention on the smallest companies in terms of market cap — for example, US WEST Communications, though acquisition of USW would require some sort of roll-up and then spin-off of the U S WEST Media Group tracking stock (UMG). Incidentally, geographically, U S WEST sits right in between PacTel and SBC and thus down the road seems a logical candidate for further footprint extension, although **we do not believe a 3-way RBOC mergers will occur until after the RBOCs are granted long distance authority (1997 at the earliest) and the proposed 2-way mergers are approved by the Justice Department.**

Investment Recommendations

The year-to-date 13% underperformance of the RBOC group, due mostly to the down trend in the bond market, has created attractive valuations for the RBOCs and GTE. We continue to see **25% average price appreciation upside (plus average dividend yields of 4.6%) from the RBOC/GTE group.** We see the greatest upsides for SBC, Ameritech and BellSouth.

Table 4

RBOCs/GTE Target Prices
(as of May 14, 1996)

	Current Price	1996E EPS	Current P/E Multiple: x Est 1996 EPS	Current P/E Multiple: Relative to S&P	Mult Relative to Avg RBOC	Targeted Premium	Targeted P/E Multiple: x Est 1996 EPS	Targeted P/E Multiple: Relative to S&P	Target Price	Appreciation Potential
Ameritech	$58.75	$3.82	15.4	0.91	1.05	18%	19.9	1.18	$75.96	29%
Bell Atlantic	$64.88	$4.30	15.1	0.90	1.03	RSTR	RSTR	RSTR	RSTR	RSTR
BellSouth	$41.13	$2.50	16.5	0.96	1.13	20%	20.2	1.20	$50.55	23%
NYNEX	$48.63	$3.57	13.6	0.81	0.93	RSTR	RSTR	RSTR	RSTR	RSTR
Pacific Telesis	$33.88	$2.60	13.0	0.77	0.89	-15%	14.3	0.85	$37.24	10%
SBC Comm	$50.13	$3.45	14.5	0.86	1.00	24%	20.9	1.24	$72.09	44%
U S WEST Comm.	$34.38	$2.45	14.0	0.83	0.96	-5%	16.0	0.95	$39.91	16%
RBOC Average			14.6	0.87	1.00	8%	18.3	1.08		25%
GTE	$44.38	$2.87	15.5	0.92	1.06	10%	18.5	1.10	$53.20	20%
S&P 500	$665	$39.50	16.9	1.00						

Target Multiple: 10% Average Premium to Market

As shown in Table 4, while the average RBOC trades at 14.6 times our 1996 EPS estimates, a 13% discount to the S&P 500; and GTE trades at 15.5x, an 8% discount. **We continue to believe the average RBOC can appreciate to a 10% premium to the market's multiple.** Our logic for a 10% premium is threefold: (a) Average RBOC/GTE 5-year estimated EPS growth of 9-10% is a 10-20% premium to the S&P's secular rate of 7-8%; (b) Average dividend yields are 4.6%, double the S&P 500's; and (c) The group is more defensive in a down market and slowing economy.

Accelerating EPS Growth

As described above, we believe **the rapid replacement of ROR/earnings with price regulation and the long distance opportunity afforded by Federal legislation offset accelerated entry of competitors into the local telephone market and support accelerating EPS growth for the RBOC/GTE group**.

The 80/20 Rule Benefits RBOCs

No doubt, we will continue to hear much about how AT&T (perhaps in collaboration with MCI) plans to attack the local telephone market. One should remember, however, they may have switches and brand, but they have few easily-activated paths to the customer and thus will either have to buy access and local capacity from alternate suppliers such as MFS (MFST, $37 1/4, D-2-1-9) /q/ or from the RBOCs at wholesale rates only 20-30% below retail, by our estimates. With regard to the latter (e.g., AT&T reselling RBOC capacity at only 20-30% discounts), it is critical to point out that if an RBOC loses, say, 10% share, it translates into only 2 or 3 points of actual revenue share loss because the RBOC would recover 70-80% of retail in the wholesale rate paid by AT&T. Hence, our argument — of course, oversimplified to make the point — that competitive risk for the RBOCs is easy to overstate.

In contrast, when RBOCs gain share of the LD market, they will likely pay volume-based wholesale rates of 1.5-2 cents per minute (net of access), **a steep 70-80% discount from current retail** LD prices of 10 cents (net of 6-7 cents of access). Obviously, this is likely to translate into significant pain for the largest long distance carriers given a highly fixed cost structure (excluding access and billing, which vary directly with volume).

1Q Announcements Support Our Views:

Numerous announcements in the first quarter reinforce our views, including:

GTE Enters LD Business

1. GTE has already begun to offer long distance services to its in-region customers and intends to gain 10% of its $4.8 billion addressable long distance market within 12 months with negligible cost to the bottom line. GTE management presentations at it's quarterly analyst meeting reiterated the company's plans to achieve 10% EPS growth for the foreseeable future, despite the "negligible" startup cost of long distance entry. We also learned the company believes its long distance effort will generate positive earnings impact in 1997, which reflects, in our view, the remarkably attractive economics facing an RBOC entering an adjacent market (long distance). **How often is it that an industry wakes up one day, finds its addressable market expanded by 40% and can launch the new service without noticeable dilution and achieve positive earnings by the second year?** Most ventures of this magnitude require significant startup financing and take 4 or more years to achieve positive operating cash flow and several additional years to achieve positive EPS impact. Witness the startups of cellular, PCS, video, alternative access suppliers such as MFS; and numerous dilutive startups and acquisitions recently undertaken by AT&T (e.g., McCaw and LIN and PCS), by MCI (e.g., cellular resale, MCI Metro, NewsCorp joint venture) and by Sprint (PCS partnership with cable alliance);

RBOCs Offer Cellular LD and Take Significant Share...

2. The immediate offering of long distance service to cellular customers by Ameritech, BellSouth, Bell Atlantic/NYNEX Mobile, Southwestern Bell Mobile and GTE; for which we understand the customer response has been very positive (over 90% of new cellular subscribers have been selecting the RBOC for long distance service).

...By Reselling LD Which They Can Buy For 1.5-2 Cents/Minute

3. These same companies announcing volume and term contracts with Worldcom, LCI and Sprint for wholesale long distance capacity at rates that are surely in the 1.5-2 cent/minute range for domestic traffic; scaling down to the lower end of that range as volume thresholds are met. **This means the RBOCs will reap the profitable arbitrage between retail cellular long distance rates of 20-30 cents/ minute and the 1.5-2 cent wholesale cost.** We note cellular long distance accounts for only 2-3% of the $67 billion long distance market and the RBOCs are unlikely to convert more than 25% of their cellular customers. For these reasons, we view cellular long distance as only a small opportunity for the RBOCs and a small threat to the long distance carriers. Nevertheless, it serves to ***highlight the retail versus wholesale price arbitrage opportunity made available to the RBOCs by the legislation*** and by the RBOCs' buying power vis a vis 4 long distance network suppliers. It also serves to ***highlight the risk of commoditization that long distance companies will experience*** to the extent the FCC approves RBOCs' offering long distance service to in-region wireline customers and to the extent the RBOCs gain long distance market share.

4. **BellSouth, SBC and PacTel issued a joint RFP for long distance capacity.** The Bell companies asked the nation's long distance providers to submit bids for handling long distance calls that originate in their respective territories, which could lead to the three companies signing a joint arrangement with a single long distance carrier — a potential $400 million contract opportunity for the winning bidder calculated as follows:

   $18 billion in-region origination at retail rates
   \- $8 billion access
   = $10 billion in-region origination net of access
   x 20% market share
   x 20% ($0.02/min. wholesale = 20% of $0.10/min. retail net of access)
   = $400 million resale contract opportunity

A contract of this size is favorable to the Bell companies as it gives them the ability to use their huge potential long distance volumes to negotiate for even cheaper wholesale rates than they could negotiate for individually.

5. **NYNEX announced an agreement with Sprint for out-of-region long distance resale.** NYNEX outsourced transport, telemarketing, billing and customer service to Sprint. We believe the outsourcing for out-of-region termination is permanent but the other functions are only temporary until the "new" Bell Atlantic's (i.e. merged BEL/NYN) in-house long distance unit is up and running. The Sprint agreement allows this flexibility.

6. Separately, **Bell Atlantic also entered into a similar out-of-region long distance resale arrangement with Sprint.** The details of their agreement are not available, but we believe Bell Atlantic has contracted primarily for out-of-region transport. We suspect the LD transport rates are less than $0.02/minute, perhaps closer to $0.015/minute.

Our Favorites are SBC and Ameritech

Our ratings remain unchanged as follows: Ameritech (B-2-1-7), BellSouth (B-2-2-7), Pacific Telesis (B-2-2-8), SBC (B-2-1-7), U S WEST (B-2-2-7) and GTE (B-2-2-7). We are restricted on Bell Atlantic and NYNEX. Our price objectives now show greatest upside in shares of Ameritech (29% to $76, plus 3.6% yield); and SBC (44% to $72, plus 3.4% yield); and BellSouth (23% to $50 1/2, plus 3.5% yield). Our price objectives assume the RBOC/GTE group trades near a 10% P/E premium to the S&P's 16.9x estimated 1996 EPS, with AIT, BLS and SBC at 10%, 12% and 16% premiums to the group, respectively, given best-of-group growth prospects (10%+), lowest dividend payout ratios, and 100% movement away from rate of return regulation.

Table 5

Recent Stock Performance

(As of May 14, 1996)

Company	Price @ 5/14/96	Price Appreciation Since 7/18/95	12/31/90	12/31/91	12/31/92	12/31/93	12/31/94	12/31/95	6/30/92	4/6/93	3/31/95	6/30/95	9/30/95	3/31/96
Ameritech	$58.75	29.1%	76.0%	85.0%	64.9%	53.1%	45.5%	-0.2%	86.9%	49.9%	42.4%	33.5%	12.7%	7.8%
Bell Atlantic	$64.88	18.2%	21.0%	34.5%	26.6%	9.5%	30.4%	-3.0%	45.8%	17.7%	22.7%	15.8%	5.7%	4.8%
BellSouth	$41.13	31.6%	50.2%	58.9%	60.1%	41.8%	52.0%	-5.5%	66.6%	45.6%	38.2%	29.5%	12.5%	11.1%
NYNEX	$48.63	19.7%	36.7%	20.4%	15.9%	21.2%	32.3%	-10.0%	23.3%	7.0%	23.1%	20.8%	1.8%	-2.5%
Pacific Telesis	$33.88	30.9%	NA	NA	NA	NA	18.9%	1.1%	NA	NA	12.0%	26.6%	10.2%	22.1%
SBC Comm.	$50.13	9.0%	79.0%	55.1%	35.5%	20.8%	24.1%	-12.4%	64.3%	28.5%	19.3%	5.2%	-8.9%	-4.8%
U S WEST (Media & Comm.) [1]	$53.25	29.1%	37.0%	40.6%	38.8%	16.1%	49.5%	-2.5%	45.9%	21.7%	32.7%	27.9%	12.7%	0.0%
U S WEST Comm.	$34.38	NA	NA	NA	NA	NA	NA	-3.5%	NA	NA	NA	NA	NA	5.4%
RBOC Average [2]		23.9%	50.0%	49.1%	40.3%	27.1%	36.1%	-4.8%	55.5%	28.4%	27.2%	22.8%	6.7%	6.3%
GTE	$44.38	27.7%	51.7%	28.2%	28.2%	26.8%	46.1%	1.1%	39.2%	18.7%	33.5%	30.0%	13.4%	1.4%
S&P 500	666	19.2%	101.6%	59.6%	52.8%	42.7%	44.9%	8.1%	63.1%	50.9%	32.9%	22.2%	13.9%	3.1%
30-Yr Treas. Index Value	116	-4.4%	7.1%	-0.7%	0.3%	-10.2%	9.7%	-12.4%	3.9%	-4.1%	4.9%	-5.0%	-6.1%	-2.9%

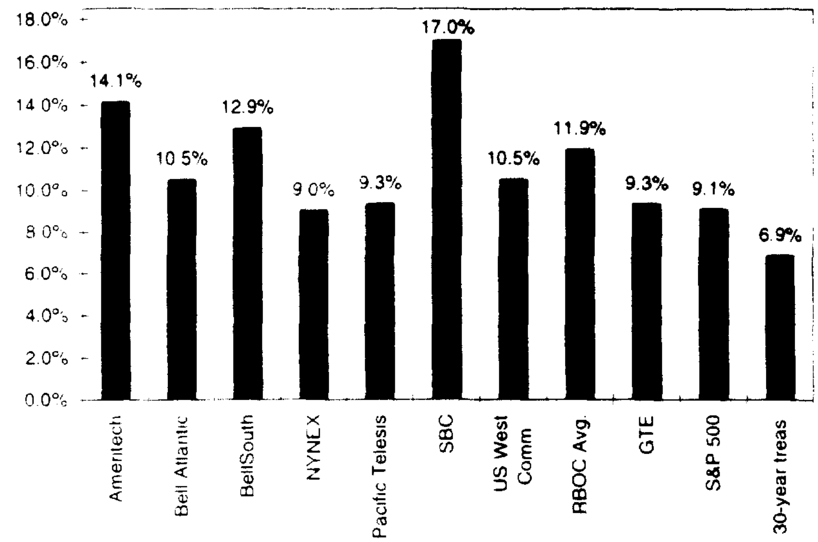
[1] For comparative purposes only, U S WEST price is the sum of current Communications Group (USW) and Media Group (UMG) stock price

[2] Average includes U S WEST Communications only in those periods where it is available, otherwise it includes Media & Communications combined.

RBOCs Clearly Offer Better Total Return Potential than the S&P 500 and the Long Bond

Chart 1

5-Year Annualized Total Return Potential*



* Merrill Lynch estimate

Table 6

5- Year EPS Growth Forecast and Potential Dividend Growth*

	EPS			Dividend		
Company	1995	2000E*	5-year CAGR	1995	2000E*	Implied CAGR
Ameritech	3.41	5.49	10.0%	2.00	3.30	10.5%
Bell Atlantic	3.88	6.25	10.0%	2.80	3.75	6.0%
BellSouth	2.24	3.60	10.0%	1.38	2.16	9.4%
NYNEX	3.28	4.82	8.0%	2.36	2.89	4.1%
PacTel	2.46	3.14	5.0%	2.18	2.51	2.9%
SBC	3.08	5.19	11.0%	1.65	3.11	13.5%
U S WEST	2.35	3.30	7.0%	2.14	2.64	4.3%
RBOC Avg.			8.7%			7.2%
GTE	2.61	4.02	9.0%	1.88	2.41	5.1%

*Assumes achievement of 5-year EPS growth and targeted payout ratio of 60% by year 2000 (80% for Pacific Telesis and U S WEST Communications).

Table 7

Total Return Potential*

Company	(a) Implied Div Grwt	+ (b) Current Yield	= (c) Total Return	(d) Relative Tot Ret*	(e) Rel P/E 95 EPS	(e)/(d) Rel. P/E to Rel. Tot. Ret.	Tot Return: P/E
Ameritech	10.5	3.6%	14.1%	1.56	0.96	0.62	81.9%
Bell Atlantic	6.0	4.4%	10.5%	1.15	0.94	0.81	62.5%
BellSouth	9.4	3.5%	12.9%	1.42	1.03	0.73	70.0%
NYNEX	4.1	4.9%	9.0%	0.99	0.83	0.84	60.7%
Pacific Telesis	2.9	6.4%	9.3%	1.03	0.77	0.75	67.6%
SBC	13.5	3.4%	17.0%	1.87	0.91	0.49	104.3%
US West Comm	4.3	6.2%	10.5%	1.16	0.82	0.71	71.7%
RBOC Avg.	7.2	4.6%	11.9%	1.31	0.89	0.68	74.4%
GTE	5.1	4.2%	9.3%	1.03	0.95	0.93	54.8%
S&P 500	7.0	2.1%	9.1%	1.00	1.00	1.00	50.8%
30-year treas.	0.0	6.9%	6.9%				

Average Total Return 500 b). above the long bond.

*Merrill Lynch estimate; theoretical total return, assuming all RBOCs and GTE achieve a targeted payout ratio of 60% by 2000 (PAC and USW target of 80%).

Table 8

RBOCs and GTE
First Quarter Earnings Comparisons 1996 vs 1995

	Recurring*			Reported	One Time
	1Q96	1Q95	% Chg	1Q96	Charges
Ameritech	0.86	0.76	13.7%	0.86	0.00
Bell Atlantic	1.07	0.95	12.8%	1.07	0.00
BellSouth	0.63	0.55	13.7%	0.98	-0.35
NYNEX	0.83	0.72	15.0%	0.79	0.04
Pacific Telesis	0.70	0.67	4.6%	0.70	0.00
SBC	0.76	0.65	17.2%	0.76	0.00
U S WEST Comm	0.61	0.59	4.5%	0.69	-0.08
RBOC Avg			**11.5%**		
Excl. PAC and USW			**14.5%**		
GTE	0.62	0.56	10.7%	0.62	0.00

Table 9

RBOCs and GTE
Recurring Annual EPS Comparisons 1995-1997E*

	1995A	1996E	96E/'95A % Chg	1997E	97E/'96E % Chg
Ameritech	$3.41	$3.82	12.0%	$4.25	11.4%
Bell Atlantic	$3.88	$4.30	10.8%	$4.95	15.0%
BellSouth	$2.24	$2.50	11.4%	$2.75	10.0%
NYNEX	$3.28	$3.57	9.1%	$3.87	8.3%
Pacific Telesis	$2.46	$2.60	4.9%	$2.45	(5.7%)
SBC	$3.08	$3.45	12.1%	$3.70	7.0%
U S WEST Comm	$2.35	$2.45	4.7%	$2.60	5.8%
RBOC Avg			9.3%		7.4%
GTE	$2.61	$2.87	10.4%	$3.15	9.8%

* All figures adjusted to exclude one-time items. E=Merrill Lynch Estimates.

First Quarter Results Beat Expectations

The RBOCs' recurring earnings in the first quarter were better than expectations. Six of the seven RBOCs beat our estimates (Pacific Telesis by $0.06, Bell Atlantic by $0.04, BellSouth by $0.03, Ameritech and NYNEX each by $0.02, and SBC by $0.01). GTE and U S WEST reported 1Q EPS in line with our estimates. The RBOCs recurring first quarter EPS growth averaged 11.5%, greater than the fourth quarter's growth of 5.8% and our 9% forecast. SBC led the RBOCs with an EPS gain of 17.2%, followed by NYNEX (15.0%), BellSouth and Ameritech (13.7%), Bell Atlantic (12.8%) and GTE (10.7%). US WEST Communications and PacificTelesis showed the weakest first quarter results with recurring EPS growth of 4.5% and 4.6% respectively. . Excluding PacTel and U S WEST, EPS growth for the remaining five RBOCs averaged a very impressive 14.5% in the first quarter, up significantly from the fourth quarter's 9.0%.

Estimates increased for AIT, BEL, BLS, NYN, PAC, & SBC; No Change to GTE & USW

Following the first quarter results, we raised our 1996 and 1997 estimates for Bell Atlantic (by $0.05 in '96 to $4.30 and $0.30 in 97 to $4.95 to reflect merger synergies), NYNEX (by $0.02 to each to $3.57 and $3.87), Ameritech (by $0.07 in '96 to $3.82 and $0.10 in '97 to $4.25), BellSouth (by $0.05 in '96 to $2.50 and $0.08 in '97 to $2.75), Pac Tel (by $0.10 in both '96 and '97 to $2.60 and $2.45 respectively). We also raised both our 1996 and 1997 estimate for SBC from $3.42 to $3.35, and $3.67 to $3.70 respectively. There were no changes to U S WEST's and GTE's estimates. For all seven RBOCs together, we now forecast average recurring EPS growth of 9.3% in 1996 and 7.4% in 1997. Excluding Pacific Telesis and U S WEST we forecast average growth of 11.0% in 1996 and 10.4% in 1997

Line Growth and Minute Growth Accelerated

Access line growth averaged 4.3% in the first quarter, much better than our forecast of 4.0% and the fourth quarter's 3.9%. High usage business line growth accelerated to 6.8%, up from the fourth quarter's 6.5%, while residential line growth accelerated to 3.3% from 2.8% in the fourth quarter due to continued aggressive second line marketing campaigns by all of the RBOCs, increasing second line penetration and favorable economic conditions in most regions. Over half of new residential lines are second lines for fax machines, home offices, internet services, children, etc. Faster business line growth relative to residential line growth is leading to an incrementally richer mix in the average RBOC's customer base. The RBOCs are also actively promoting special features such as Caller ID, Call Waiting and voice messaging to drive residential revenue and operating income per line.

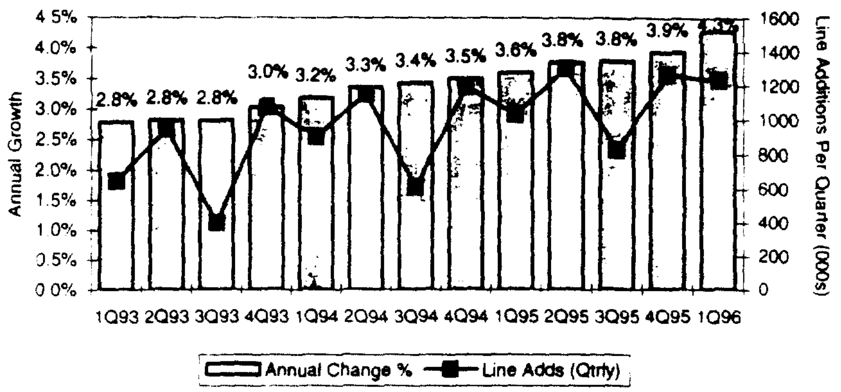
Pac Tel showed the greatest improvement in line growth, jumping 90 basis points to 3.9% from the fourth quarter's 3.0%, followed by SBC with a 40 basis point improvement, and BellSouth a 30 basis point improvement. GTE again led the group with total line growth of 6.2%, followed by SBC with 4.9% line growth and BellSouth and U S WEST with 4.8% growth. Bell Atlantic, despite a 10 basis point acceleration, lagged the group with line growth of only 3.5%. U S WEST led the group in business line growth improvement, with an impressive 130 basis point jump from 5.9% in 4Q to 7.2% in 1Q. Pacific Telesis improved 50 basis points and NYNEX 30 basis points. BellSouth reported the strongest business line growth, 7.9% year-over-year, in line with fourth quarter's growth.

Average long distance minutes of use grew 10.8% year-over-year in the first quarter, up 120 basis points from the fourth quarter's 9.6%. Bell Atlantic led the group with minute growth of 12.7%, followed by NYNEX (11.0%), BellSouth and SBC (10.8%) and Ameritech (10.4%). Bell Atlantic showed the greatest sequential improvement, jumping 450 basis points from the fourth quarter's 8.2% growth which was partially caused by harsh winter weather in the Northeast.

RBOC Line Growth Accelerated in 1Q96

Chart 2

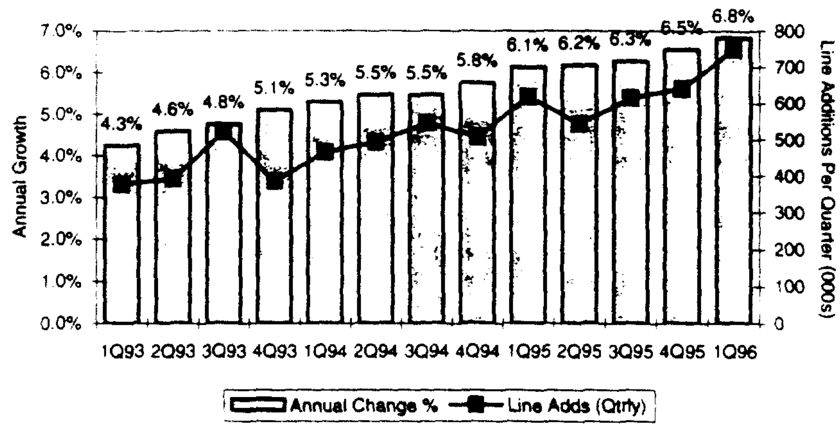
Average RBOC Line Growth



Strong Business Line Growth

Chart 3

Average RBOC Business Line Growth



Minute Growth Accelerated

Chart 4

Average RBOC Minute of Use Growth

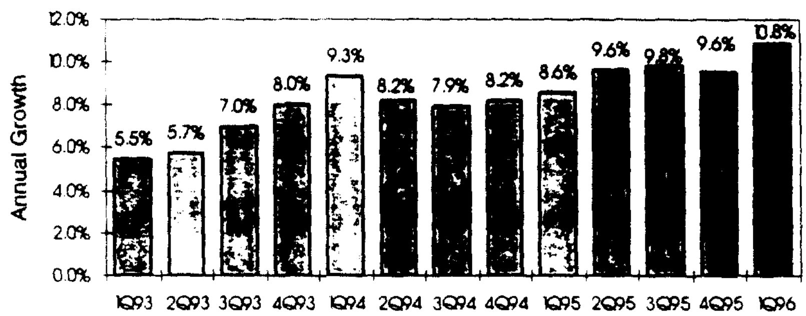


Table 10

Access Line and Minute Volumes
(Year-Over-Year % Growth By Quarter)

	Total Lines					Access Minutes				
	1Q95	2Q95	3Q95	4Q95	1Q96	1Q95	2Q95	3Q95	4Q95	1Q96
AIT	3.8%	4.2%	4.4%	4.5%	4.5%	6.9%	8.7%	8.7%	9.1%	10.4%
BEL	2.9%	3.1%	3.3%	3.4%	3.5%	6.8%	8.6%	8.3%	8.2%	12.7%
BLS	4.6%	4.8%	4.7%	4.5%	4.8%	8.9%	9.6%	9.7%	9.0%	10.8%
NYN	3.3%	3.2%	3.0%	3.4%	3.6%	6.0%	9.0%	9.4%	10.4%	11.0%
PAC	2.8%	2.9%	2.7%	3.0%	3.9%	10.8%	10.7%	11.0%	11.0%	9.9%
SBC	3.6%	4.0%	4.2%	4.5%	4.9%	11.0%	11.1%	11.3%	10.0%	10.8%
USW	4.2%	4.2%	4.2%	4.2%	4.8%	9.6%	9.4%	10.3%	9.3%	10.3%
RBOC Avg	3.6%	3.8%	3.8%	3.9%	4.3%	8.6%	9.6%	9.8%	9.6%	10.8%
GTE*	5.1%	5.4%	5.7%	6.2%	6.2%	7.5%	10.3%	9.9%	10.7%	6.3%

* Includes International Lines.

Table 11

RBOC Access Line Growth by Segment and Quarter
(Year-Over-Year % Growth By Quarter)

	Residential Line Growth					Business Line Growth				
	1Q95	2Q95	3Q95	4Q95	1Q96	1Q95	2Q95	3Q95	4Q95	1Q96
AIT	2.3%	2.6%	2.9%	3.1%	3.1%	7.0%	7.2%	7.2%	7.2%	7.3%
BEL	2.0%	2.1%	2.2%	2.4%	2.7%	4.8%	5.2%	5.5%	5.5%	5.2%
BLS	3.4%	3.7%	3.5%	3.2%	3.5%	7.7%	7.7%	7.7%	7.9%	7.9%
NYN	1.8%	1.9%	1.8%	1.8%	2.0%	6.5%	6.1%	5.8%	6.7%	7.0%
PAC	2.1%	2.2%	1.8%	2.1%	3.1%	4.2%	4.1%	4.4%	4.9%	5.4%
SBC	2.3%	2.7%	2.8%	3.1%	3.6%	6.9%	7.0%	7.4%	7.8%	7.8%
USW	3.7%	3.6%	3.6%	3.6%	3.8%	4.8%	5.7%	5.9%	5.9%	7.2%
RBOC Avg	**2.5%**	**2.7%**	**2.7%**	**2.8%**	**3.3%**	**6.1%**	**6.2%**	**6.3%**	**6.5%**	**6.8%**

1Q Cellular Results In Line With Expectations

Average Annualized Penetration Gain of 2.15%, Up From 1.66% in 1Q95.

First quarter cellular gains were in-line with expectations. All of the RBOCs met or beat our estimates while GTE reported cellular gains well below expectations. Cellular subscribers grew 35% y/y down from 39% in 4Q95. This slow down was expected due to two factors: seasonal trends and an industry wide deceleration as the subscriber base grows. Annualized penetration gains averaged 2.15%, up from the 1Q95's average of 1.66%. Ameritech led the group with an annualized penetration gain of 2.87% just shy of our forecast of 2.96% and up almost 40 basis points from 2.51% in the year ago first quarter. U S WEST New Vector reported the second best annualized penetration gain in the first quarter; 2.67% was in line with our estimate, and up more than 100 basis points from the year-ago first quarter. As expected, Bell Atlantic/NYNEX Mobile (BANM) reported the lowest annualized penetration gain of the RBOCs, but its 1.57% was still better than 1Q95's 1.29%. GTE reported an annualized penetration gain of only .54%, 32 basis points below our expectation and down significantly from 1Q95's 1.21% as GTE is still (according to company management) directing its attention toward adding "better- quality" customers and reducing its "way too high" monthly churn rate. During 1Q96 GTE's churn was 2.4%, down 30 basis points from the previous quarter (Industry average churn is about 2%).

Average Subscriber Growth of 35.1% Was Less than Expected

RBOC subscriber growth averaged 35.1% year-over-year, down from 39% in the prior quarter due to the larger subscriber base and seasonal trends, and 3% less than our forecast. Average total penetration for the group is now 7.5%, led by SBC with 9.5% penetration. U S WEST New Vector reported the strongest growth with subscribers up 54% year-over-year and total penetration of 8.2%, followed by Ameritech with growth of 42.7% year-over-year and total penetration of 8.4%.

Cellular Revenues Up 26.5%, Rev/Sub Trend Worse than 4Q

For the four companies that disclose revenue data, cellular revenues grew an average 26.8% annually, compared to a 35.1% average gain in the number of subscribers. The gap reflects an average 6.9% year-over-year decline in revenue per subscriber in the first quarter, worse than the fourth quarter's 5.4% average decline. BellSouth and SBC showed the lowest estimated revenue per subscriber decline (1.7% and 5.4%, respectively), but also reported the slowest year-over-year subscriber growth due to costly scaled back special promotions and discounts. In contrast, U S WEST, which reported the strongest quarterly gains, saw revenue per subscriber decline 9.4%. BANM reported a 8.1% year-over-year decline.

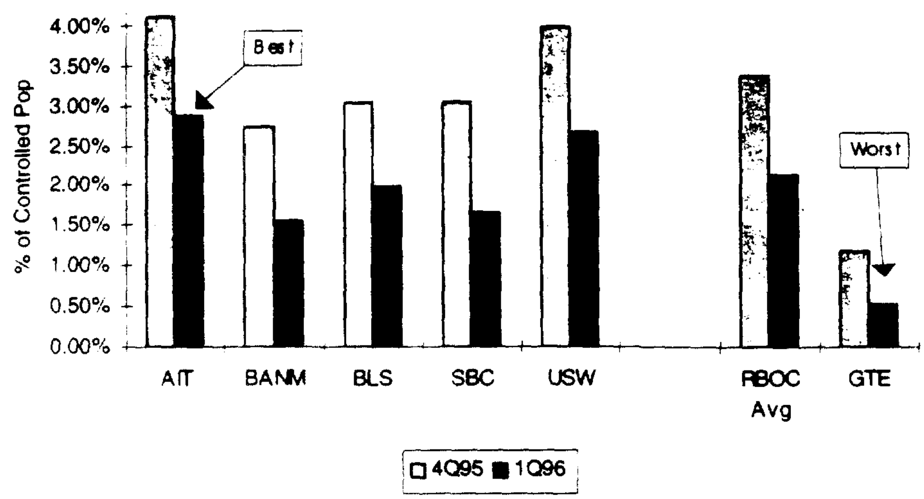
Operating Cash Flow Margins Improved

For the four companies that report data, cellular operating cash flow margins averaged 39%, up from 37% in both the year ago first quarter and the fourth quarter 1995. SBC led the group with an OCF margin of 43.5%, a surprising improvement from 4Q's 39.1% and up from 40% in the year-ago 1Q. BellSouth reported and OCF margin of 40.3%, in line with 1Q95's 40.2%. BANM reported an OCF margin of 42%, up from 29.4% in the year-ago quarter. Finally, U S WEST's OCF margin rose to 36.0% from 33.6% in 1Q95. GTE's operating cash flow margins decreased from 36.4% in 1Q94 to 34.8%.

Annualized Penetration Gains Are 2.2% Led by AIT and USW, GTE Lags Group

Chart 5

Cellular Penetration Gains (Annualized)*

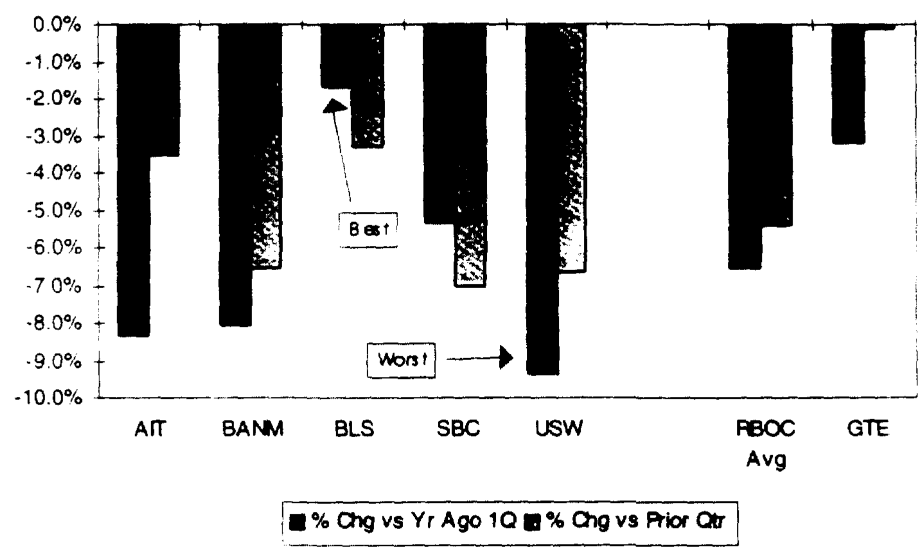


* Domestic Only

Rev/Sub Down 6.6% Y/Y

Chart 6

Revenue Per Subscriber Decline*



* Domestic Only

Table 12

Cellular Penetration Gains (Annualized)

(% of Total Population)

	1Q96	4Q95	1Q95
Ameritech	2.87%	4.09%	2.51%
Bell Atlantic/NYNEX Mobile	1.57%	2.74%	1.29%
BellSouth	1.99%	3.03%	1.63%
SBC	1.66%	3.05%	1.25%
U S WEST Media	2.67%	3.98%	1.62%
RBOC Avg	2.15%	3.38%	1.66%
GTE	.54%	1.18%	1.21%

* Penetration-gain data reflect net subscriber additions, (annualized/adjusted for acquisitions), divided by population in properties. All data are based on POPs and subscribers in controlled markets, except for BLS, PAC, and SBC, which are measured on an equity basis, adjusting for percent ownership in properties. NA = Not applicable.
Source: Company Reports and Merrill Lynch Estimates

Table 13

Cellular Revenue Per Subscriber Trend

(% Change)

	Est Rev/Sub	
	vs.1Q95	vs. 4Q95
Ameritech	-8.4%	-3.5%
Bell Atlantic/NYNEX Mobile	-8.1%	-6.6%
BellSouth	-1 7%	-3.3%
SBC	-5.4%	-7.0%
U S WEST	-9.4%	-6.7%
RBOC Avg	-6.9%	-5.4%
GTE	-3.2%	0.0%

Source: Merrill Lynch Estimates

Cellular Net Additions But Y/Y Growth Slows

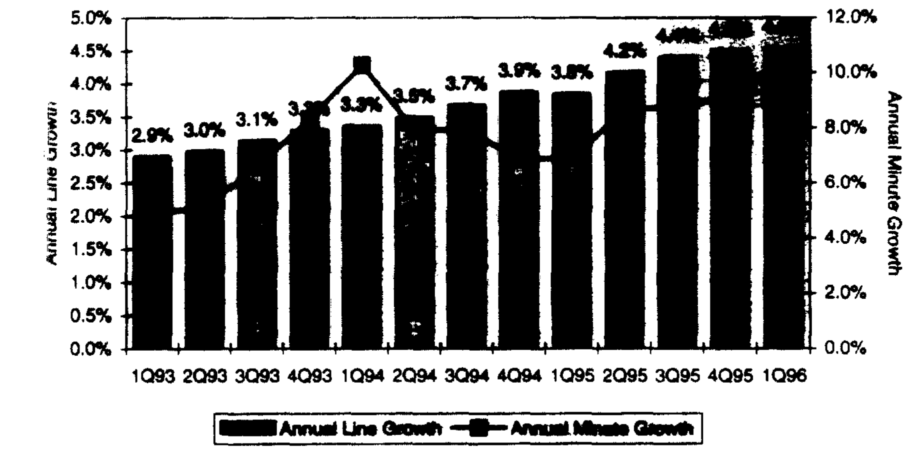
- Ameritech reported a 42.7% year-over-year increase in cellular subscribers, a slowdown from the fourth quarter's 46% growth, and consistent with an expected industry wide slowdown as the subscriber base gets larger. This was in line with our forecast of 43% growth. Ameritech added 152,000 subscribers in the quarter for an annualized penetration gain of 2.9%, down from 4.1% in 4Q due to seasonal trends. Ameritech continued to lead the RBOC in terms of penetration gains. Average revenue per subscriber dropped slightly to $50-55/month range from $55-60 a year ago — a trend in line with the industry average decline. Finally, churn was less than 1% per month, remarkably half the industry average

Ameritech Expects to Gain Approval for LD Entry by 1Q 1997

- Ameritech expects to complete the checklist requirement in Michigan and Illinois by the second half of 1996 and gain approval for long distance entry in those states by 1Q97. The major issue remaining in both states is unbundled resale rates. In Illinois, there are 5 certified local competitors and Ameritech has reached resale agreements with two. The very good news is that most of costs of long distance entry have already been incurred and the cost of long distance capacity is as low as 15% of retail (net of access) — therefore there will be very little incremental costs of entry. In fact, on the conference call Ameritech stated they have now lowered their forecasted capital cost of entry from two month's operating cash flow to almost zero.

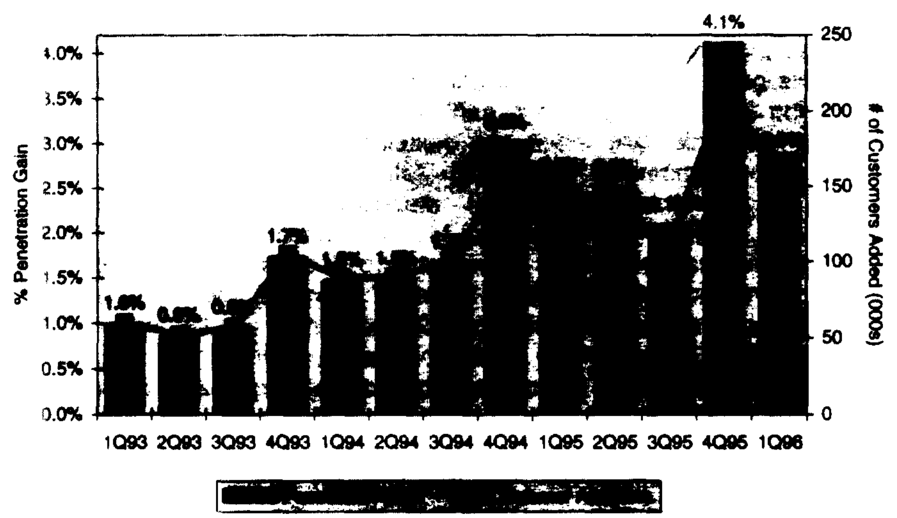
Ameritech: Line Growth Stable, Minute Growth Accelerated

Access-Line and Minute Growth



RBOC Leading Cellular Gains in 1Q

Cellular Subscriber Adds and Penetration Gain*



* Penetration-gain reflect net subscriber additions (annualized) divided by population in properties.

Investment Conclusion

We continue to rate Ameritech shares Accumulate (2) in the intermediate term and Buy (1) in the long-term (B-2-1-7), Ameritech's management believes the very strong top line growth in the first quarter will continue throughout the year. Revenue growth for the core business is still growing at an estimated 11%+. In addition, Ameritech's international investments continue to surprise us with accelerating growth. For these reasons, we now believe Ameritech will be able to exceed 10% EPS growth in 1996 & 1997 — *the minimum needed to meet AIT's targeted double-digit growth.* It has aggressive plans for entry into long distance as evidenced by an already-established long distance subsidiary and business plan. Ameritech also continues to expand its video initiatives. Ameritech continues to be one of our favorite two RBOCs.

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Bell Atlantic

BEL – $64 7/8

QRQ	Shares	EPS		EPS			EPS Growth Rate	
Rating	Out	1Q96A	1Q95A	1995A	1996E	1997E	96/95E	97/96E
RSTR	440	$1.07	$0.95	$3.88	$4.30	$4.95	10.8%	15.0%

EPS figures are on recurring basis and thus do not reflect one-time items.

1Q EPS Better Than Expected, According to the Company Merger Should be Accretive to EPS, Raised '96E & '97E

- Bell Atlantic reported 1Q EPS of $1.07, $0.04 above our forecast, $0.03 above consensus and 12.8% above 1Q95's $0.95. We raised our 1996 and 1997 estimates by $0.05. 1996 EPS now forecasted to be $4.30. According to the announcement, the Bell Atlantic/NYNEX merger should be accretive to EPS in the first year after closing (expected in about 12 months). We raised our 1997 estimate an additional $0.25 to $4.95 to reflect merger synergies and our 5-year EPS growth forecast by 200 b.p. from 10% to 12%.

Strong Fundamental Growth, Expenses Lower than Expected Due to Lower Depreciation & Interest Expenses

- Bell Atlantic reported strong fundamental growth in the first quarter. While total revenues grew only 1.2% year-over-year, in line with our forecast., normalized revenue growth was 5.3% excluding the effect of the Oct. '95 sale of the Business Systems Services unit and 7.7% including now-deconsolidated cellular growth. Network services revenues grew 5.7% vs. our forecast of 3.1%, offset by slower than expected growth in other areas like Directory Advertising and Other Ancillary Service. Value added services revenue grew 13.8% vs. our forecast of 14% and in line with the fourth quarter's trend. This growth was stimulated by an aggressive Caller ID promotion, combined with strong growth in voice messaging and answer call. Operating expenses grew about 1.1% year-over-year, better than our forecast of 1.6% primarily due to lower than expected depreciation (up 6.4% excluding the effect of the Business Systems Services sale). Normalized operating income totaled $808 million, up 2.2% year-over-year (excluding the effect of discontinued operations), slightly higher than our forecast of $794 million. Interest expense was down year-over-year due to lower debt balances. Sale of conflicted cellular properties, Business Systems Services, and strong free cash flow has allowed Bell Atlantic to reduce debt significantly. Short term debt dropped over $650 million year-over-year and long-term debt dropped over $535 million. As a result, interest expense declined by about $12 million year-over-year and $20 million sequentially and was about $16 million lower than our forecast. This combined with the $12 million positive variance in operating income vs. our forecast, accounted for the $0.04 positive EPS surprise vs. our forecast.

Merger Should Create Synergies, Expense Savings

- The merger announcement from Bell Atlantic and NYNEX included indications that the deal would be accretive to EPS in the first year after closing (expected in early 1997) and that synergies would result in $300 million in annual expense savings within a year from closing, growing to annual savings of $600 million by the third year. Our new 1997 estimate is driven by cost savings only. Beyond 1997, management expects additional cost savings are — an additional $150 million in 1998 and then another $150 million in 1999, accumulating to annual cost savings of $600 million by the third year following closing. Annual capital expenditure savings of $250-300 million are also expected according to management. One-time transition and integration charges of $500 million are expected in the first year following closing with another $200-400 million expected over the two succeeding years. The company is targeting an additional boost on the revenue side which is not factored into our revised estimate.